

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

In the Matter of)	
)	
Elimination of Rate-of-Return Regulation of)	RM No. 10822
Incumbent Local Exchange Carriers)	
)	
Federal-State Joint Board on Universal Service)	CC Docket No. 96-45

Reply Comments of TCA

I. Introduction

TCA hereby submits these reply comments in the above-noted proceeding concerning Western Wireless Corporation's ("WWC") Petition for Rulemaking requesting the Commission eliminate rate-of-return ("RoR") regulation for rural incumbent local exchange carriers ("LECs").¹ TCA is a management consulting firm providing financial, regulatory, management and marketing services for over eighty small, rural LECs throughout the United States. TCA's clients, all subject to RoR regulation, receive support from federal universal service support mechanisms, based on specific rules and regulations and will be directly impacted by a decision made in this proceeding. These comments address the concerns of TCA's clients.

TCA agrees with other commenters that the WWC Petition should be denied, because (1) it is duplicative of other proceedings before the Commission;² (2) consists of little more than a collection of faulty reasoning, misquotations and innuendo with the sole purpose of smearing rural LECs; and (3) its primary purpose is to detract attention from another Commission

¹ Petition for Rulemaking to Eliminate Rate-of-Return Regulation of Incumbent Local Exchange Carriers, *In the Matter of Elimination of Rate-of-Return Regulation for Incumbent Local Exchange Carriers*, RM-10822 and *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, filed October 30, 2003 (WWC Petition).

² See *In the Matter of: Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers, Federal-State Joint Board on Universal Service, Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation and Prescribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, CC Dockets Nos. 00-256, 96-45, 98-77 and 98-166, FCC 01-304, 16 FCC Rcd. 460, paras. 212-276 (MAG Order and FNPRM)

proceeding.³ TCA notes that the commenters supporting the WWC Petition merely regurgitate many of allegations in the Petition while, identical to WWC, offering no supporting evidence. Accordingly, the Commission should soundly reject this Petition for what it truly is – a baseless pack of allegations against the carriers that WWC considers to be its competitor, not for universal service *customers*, but for federal universal service *funds*.

II. Rural LECs Want to Ensure Equitable Competition – Not Prevent Competition.

Centennial Communications alleges that the existence of disputes regarding competitive eligible telecommunications carrier (“ETC”) designations for wireless carriers is evidence that rural LECs want to maintain their “monopoly domains.”⁴ Centennial, like WWC, chooses to ignore the fact that rural LECs have been competing with wireless carriers for years. Wireless carriers have built networks in larger towns and along major highways in rural America where customer concentration is high and costs are low. After several years of artificial competition, the evidence is quite clear. Wireless carriers do not seek ETC status to advance universal service, but merely to secure dollars from federal and state high-cost support mechanisms for an existing wireless customer base. Rural LECs -- who actually provide universal service and rely upon the support mechanisms to recover uneconomic investment in high-cost areas -- have every right to be concerned as WWC and other wireless carriers manipulate the ETC designation process in a never-ending quest for this “obligation-free” money. Federal support mechanisms received by wireless ETCs is growing at a staggering rate and, if allowed to continue, will place these funds and the national policy of universal service in jeopardy.

One of the many of abuses of the ETC designation process is the circumvention of the requirement to serve the entirety of the service area.⁵ Wireless carriers have successfully

³ See *Federal-State Joint Board on Universal Service Seeks Comment on Certain of the Commission's Rules Relating to High-Cost Universal Service Support and the ETC Designation Process*, CC Docket No. 96-45, FCC 03J-1, released February 7, 2003 (Portability Proceeding)

⁴ *In the Matter of Elimination of Rate of Return Regulation of Incumbent Local Exchange Carriers*, Comments of Centennial Communications Corp., RM 10822, filed January 16, 2004, p. 2

⁵ Section 214(e)(1) of the 1996 Act states that an ETC must 1) be a common carrier, 2) offer the services supported by universal service support mechanisms under Section 254(c), 3) offer these services throughout the service area for which the designation is received and 4) advertise the availability of such services and the associated charges.

employed “bait and switch” tactics in low-density, high cost states where traditional wireless coverage rarely encompasses an entire rural LEC exchange, let alone a rural LEC study area.⁶ WWC pioneered this technique, by offering to compete against rural LECs with a fixed wireless offering, which had a much greater range than its traditional wireless handset. This enabled WWC to contend that this service offering allowed it to meet the requirement to offer the supported services throughout the entire service territory.⁷ Of course, few customers actually subscribed to this service, as its quality and data speed was typically inferior to the similarly priced service offered by rural LECs. However, the “Wireless Residential Service” offering served as WWC’s “Trojan Horse” and on November 21, 2002, in a series of *ex parte* presentations to the FCC, WWC discussed plans to “expand its provision federally-supported universal service.”⁸ In a footnote in the *ex parte* letter documenting these meetings, WWC states:

In this regard, and for the purposes of updating the record in connection with two eligible telecommunications carrier decisions issued in this docket, Western Wireless intends to apply the federal universal service support that it receives to the full range of its offerings that satisfy the eligible telecommunications criteria, including rate plans provided to customers using conventional cellular handsets, as well as the “Wireless Residential Service” rate plan provided to customers using special terminal equipment.⁹

This “bait and switch,” enabled WWC to dramatically increase its nationally supported lines from 4,504 in the fourth quarter of 2002 to 176,675 in first quarter of 2003, which correspondingly increased its annualized draw from the universal service fund from approximately \$1 million to over \$30 million.¹⁰

⁶ 47 U.S.C. 214(e)(5) defines a rural LEC’s study area as its service area.

⁷ Frequently in these ETC proceedings, WWC witnesses assures state commissioners that ETC designation will be limited to its Wireless Residential Service offering. See *In the Matter of the GCC License Corporation’s Petition for Designation as an Eligible Telecommunications Carrier (d/b/a Western Wireless), Before the State Corporation Commission of the State of Kansas*, Docket No. 99-GCCZ-156-ETC, Volume 1, Transcript of Proceedings held May 9, 2000, pp. 117-118.

⁸ Letter from David L Sieradzki to Marlene H. Dortch dated November 21, 2002 Re: *Ex Parte* Presentations – Federal-State Joint Board on Universal Service, CC Docket No. 96-45, p 1.

⁹ *Id.* p 2.

¹⁰ See USAC Universal Service Fund Projection, HC01 Reports, 4th quarter, 2002, 1st quarter, 2003, found at <http://www.universalservice.org/overview/filings>. WWC is not the only wireless carrier engaging in this tactic. North East Colorado Cellular (d/b/a Viaero Wireless) was granted ETC status in Colorado on similar terms and conditions as WWC and is slated to receive \$2,147,000 in federal support for second quarter 2004. However, its fixed universal service offering is not being currently advertised on its company website (<http://www.viaero.com>).

While some state commissions have objected to this manipulation of the ETC requirements,¹¹ most have stood idly by as wireless carriers receive universal service support for thousands of low-cost conventional wireless customers simply because the wireless provider promises to make available a fixed wireless service offering to remotely located high-cost customers in the same wire center.¹² Limiting wireless ETC support to customers served by its fixed wireless service offerings, as wireless carriers initially proposed, could better ensure that federal support mechanisms are used for their intended purposes – to assure the availability of affordable telecommunications service to all consumers living in remote and high cost areas. Furthermore, as the wireless carriers fixed offering is the only service that could be legitimately argued that could be offered throughout the service territory, this approach may enable true compliance with Section 214(e)(1)(3) of the Telecommunications Act of 1996.

III. Providing Support to Wireless Carriers and the Removal of Implicit Support From Access Rates are the Reason for the Growth in Rural Support Mechanisms - Not Cost Misallocations or a Lack of Regulatory Oversight.

The Ad Hoc Telecommunications Users Committee (“Ad Hoc”) *suspects* that a number of factors are responsible for the growth in high cost support for rural LECs. Misallocation of investments, artificially low local rates and lack of regulatory oversight are among the factors cited by Ad Hoc that have produced the substantial growth in rural LEC support. Notably, Ad Hoc presents no evidence to support these allegations because, in reality, the charges represent little more than an urban myth surrounding high-cost support.

Ad Hoc cites the FCC’s 1997 audits of Regional Bell Operating Companies’ (“RBOCs”) continuing property records as evidence of cost misallocation. Undeterred by the fact that these

¹¹ See in general Application No. C-1889 *Order Approving Advertising Plan, Before the Nebraska Public Service Commission* The NPSC has insisted that WWC limit its supported service offering to its fixed wireless service. Because WWC has refused to comply, USAC identifies it as ineligible to receive support.

¹² The Colorado Public Utility Commission (CoPUC) granted Clear Talk (a PCS provider) ETC status in a mountainous area of Western Colorado absent any proof that a “yet to be developed” fixed wireless offering would provide the supported services throughout the service territory. Clear Talk merely has to represent to the CoPUC that the offering is “functioning and available for customer use.” See CoPUC Decision No. R03-1464 at page 7, mailed date December 31, 2003.

seven-year old audits were of companies subject to price cap regulation, not rate-of-return regulation, Ad Hoc reaches the “conclusion” that “it would not be unreasonable to assume that rural LECs also materially overstate relevant costs.”¹³ Until Ad Hoc can support these allegations with actual facts, the Commission should treat this unsubstantiated allegation as gibberish.

Ad Hoc repeats WWC’s unsubstantiated claim that many rural LECs receive excessive high-cost support, which enables them to charge unreasonably low local rates. Ad Hoc then “deduces” that unreasonably low retail rates eliminate any incentive for regulators to investigate rural LEC returns, which Ad Hoc suspects (again, without any support) are “creamy”.¹⁴ Ad Hoc is apparently unaware of the recent federal access reform, which substantially increased subscriber line charges,¹⁵ as well as state rate rebalancing that has resulted in substantial local rate increases among rural LECs in several states, including Wyoming, Kansas and Nebraska.¹⁶

Ad Hoc also suggests (while offering absolutely no evidence) that state commissions are shirking their section 254(e) duties to ensure that federal universal service support is being used “only for the provision, maintenance and upgrading of facilities and services for which the support is intended.”¹⁷ Again, Ad Hoc is obviously unfamiliar with the CoPUC annual certification process. In 2001, after an initial screening of the financial results of all rural LECs, the CoPUC required one-third of Colorado LECs¹⁸ to provide evidence “that would demonstrate that the federal support the company receives will be used only for the provision, maintenance and upgrading of facilities for which the support is intended.”¹⁹ Ultimately, four rural LECs were audited, which included a review of various company practices (cash management, debt management, cost allocation, capital acquisition, and capital expenditure) to satisfy the CoPUC’s obligation to the FCC. Although the CoPUC conducted a review of all rural LECs, it also

¹³ *In the Matter of Elimination of Rate of Return Regulation of Incumbent Local Exchange Carriers*, Comments of the Ad Hoc Telecommunications Users Committee, RM 10822, filed January 16, 2004, p. 6 (Ad Hoc comments).

¹⁴ Ad Hoc comments, p. 12.

¹⁵ MAG Order and FNPRM, para. 42.

¹⁶ *In the Matter of Elimination of Rate of Return Regulation of Incumbent Local Exchange Carriers*, Comments of Nebraska Rural Independent Companies, RM 10822, filed January 16, 2004, p. 11.

¹⁷ 47 C.F.R. § 54.314 requires that the state commission annually certify that rural ETCs are using federal support mechanisms for the purposes intended. Failure to receive certification results in a loss of federal support.

¹⁸ Out of a total of twenty-nine LECs in Colorado, ten were subject to additional certification regulation.

¹⁹ CoPUC Docket No. 01M-387T, Staff Report, page 3, filed November 9, 2001.

required these same providers to self-certify its use of support. In its 2002 annual certification process, the CoPUC required rural LECs to increase drastically their line extension credits. Companies resisting this mandate, or even the amount of the Staff-calculated increase, were threatened with denial of certification for continued receipt of universal service support.²⁰

Ad Hoc's allegations of a lack of oversight regarding the use of federal support mechanisms should not be disregarded, but instead redirected. Currently, wireless ETCs are constrained by little, if any, regulatory oversight regarding the use of federal support. In the example detailed above, the CoPUC did not perform any similar certification review or impose any of these requirements upon WWC (or any other wireless competitive ETC), despite the following facts:

1. WWC's high-cost support is unrelated to its costs of providing service.
2. Evidence of a failure to invest in facilities by WWC.²¹
3. Statements from WWC's CEO indicating that its universal service support was primarily being used to enhance profitability.²²

Even this Commission has only very recently placed wireless competitive ETCs under some form of reporting obligations. The Memorandum Opinion and Order designating Virginia Cellular as an ETC in five rural service areas and released January 22, 2004, was the first time the Commission required any form of specific reporting obligations regarding how a competitive ETC uses federal universal service support.²³ Commissioner Abernathy, in her supporting statement, applauded the Commission's "efforts to beef up regulatory oversight"²⁴ of competitive ETCs and stated that such requirements "are consistent with the statutory framework."²⁵

²⁰ CoPUC Docket No. 02M-394T, Staff Report, filed September 10, 2002. Staff recommended Wiggins Telephone Association be denied certification. Wiggins later modified its local tariff and was certified by the Colorado Commission.

²¹ See TCA's initial comments in the instant proceeding, filed January 16, 2004, pp. 6-7.

²² "Western Wireless (WWCA): USF Provides Upside To Our EBITDA Estimate," Salomon Smith Barney Research Note, issued January 9, 2003, p. 2. WWC CEO John Stanton was quoted as saying, "The USF subsidy represents an incremental revenue source, which we believe should improve our revenue and EBITDA estimates by \$6-8 million during the first quarter and \$24-30 million during 2003 as the incremental revenue is almost all margin."

²³ See *In the Matter of Federal-State Joint Board on Universal Service, Virginia Cellular, LLC Petition for Designation as an Eligible Telecommunications Carrier in the Commonwealth of Virginia*, CC Docket No. 96-45, Memorandum Opinion and Order, adopt. December 31, 2003, rel. January 22, 2004 (VA Cellular MO&O).

²⁴ See Separate Statement of Commissioner Kathleen Q. Abernathy, VA Cellular MO&O.

²⁵ *Id.*

As several commenters correctly observed, competitive ETC support (paid primarily to wireless carriers) is the primary cause for the growth in federal support mechanisms. While actually capturing very few customers of rural LECs, wireless ETCs have more than quadrupled their receipt of federal high-cost support, increasing from \$56 million (3rd quarter 2002) to \$251 million (3rd quarter 2003).²⁶ Unfortunately, this is only the tip of the iceberg as it is estimated that should all wireless carriers serving rural LEC study areas be granted ETC status they would receive in excess of \$2 billion in federal high-cost support.²⁷

As the Oklahoma Rural Telephone Companies explain,²⁸ the vast majority of the growth in federal high-cost support for rural LECs can be attributed to the conversion from implicit support to explicit mechanisms. The FCC's 2001 access reform for rural LECs resulted in the elimination of the usage-sensitive carrier common line access rate and replaced it with a new high-cost support mechanism, Interstate Common Line Support ("ICLS").²⁹ While this rate rebalancing was revenue-neutral for rural LECs, that was not the case for wireless competitive ETCs. The FCC's current misguided portability rules -- which provide competitive ETCs identical support as the incumbent -- will produce, in 2004, an annualized windfall of \$8.6 million of ICLS for WWC, alone.³⁰

IV. RoR Regulation is Less Susceptible to Accounting Malfeasance Than Any Other Regulatory Regime.

WorldCom claims that a lack of scrutiny of rural LEC accounting information has resulted in rate base and expense "padding" that has produced inflated access rates and universal service

²⁶ See Testimony of Bob Rowe, Chairman, Montana Public Service Commission before the House Committee on Energy and Commerce Subcommittee on Telecommunications and the Internet, "The Future of Universal Service," September 24, 2003, Illustration 6 to written testimony.

²⁷ See Letter from Jeffery Smith, OPASTCO, to Marlene Dortch, Docket No. 96-45 (filed January 28, 2003) attaching *Universal Service in America: A Congressional Mandate At Risk*, January 2003, page 21 ("OPASTCO Ex Parte").

²⁸ *In the Matter of Elimination of Rate of Return Regulation of Incumbent Local Exchange Carriers*, Comments of Oklahoma Rural Telephone Companies, RM 10822, filed January 16, 2004, p. 5 (Oklahoma Rural Telephone Companies comments).

²⁹ MAG Order and FNPRM, para. 128.

³⁰ See USAC Universal Service Fund Projection, HC01 Report, 2nd quarter, 2004, found at <http://www.universalservice.org/overview/filings/2004/Q1/>. WWC is projected to receive \$2,156,506 in ICLS for all eligible service areas. Ultimately, this amount increases to \$3,069,411 (\$12.2 million annualized) once WWC receives final ETC certification for all reported areas.

support.³¹ Amazingly, the perpetrator of one of the largest accounting frauds in the nation's history – a fraud that cost rural LECs millions of dollars in unpaid bills -- has decided to use this Petition to hurl unsubstantiated charges of accounting fraud at rural LECs.

Other commenters, in addition to WorldCom, also made similar charges, apparently based on the “case studies” contained in the WWC Petition as evidence for this allegation. As several other commenters pointed out, most of WWC's case studies involved LECs not subject to RoR regulation. For the few case studies that did actually involve rural LECs subject to RoR regulation, WWC's depiction bears little resemblance to the actual results of the audits.³² For example, the Kansas case study involving audits of KUSF support levels by the Kansas Corporation Commission (“KCC”), WWC first acknowledges “many of the proceedings resulted in stipulated settlements with no detailed findings and conclusions.”³³ This admission does not deter WWC from later alleging that reductions in KUSF support levels can be attributed to various “transgressions and misallocations.”³⁴ In reality, most of the disagreements concerning the appropriate KUSF support for the various rural LECs can be attributed to the authorized cost of capital and the timing of various pro forma adjustments.³⁵

The Oklahoma Rural Telephone Companies reveal that WWC has a history of falsely certifying as qualifying for federal high-cost support to which it is not entitled.³⁶ In this instance, the Oklahoma Corporation Commission was able to notify USAC prior to WWC unjustly receiving any federal support. Unfortunately that was not the case in Kansas, as the KCC uncovered WWC's fraudulent receipt of federal high-cost support only *after* WWC had already received the funds.³⁷ The KCC described WWC's actions as follows:

³¹ *In the Matter of Elimination of Rate of Return Regulation of Incumbent Local Exchange Carriers*, MCI Comments, RM 10822, filed January 16, 2004, p. 3.

³² See Letter to Chairman Michael Powell, Federal Communications Commission, from Larry E. Sevier, Chief Executive Officer, Rural Telephone Service Co., Inc., *Ex Parte* Communication, CC Docket 96-45, December 23, 2003.

³³ WWC Petition, Attachment A at p. 4.

³⁴ *Ibid.* pp. 5-6.

³⁵ The KCC mandated a far lower authorized cost of capital than the FCC in all the KUSF audits, including some as low as 6.86%.

³⁶ Oklahoma Rural Telephone Companies comments at p. 7

³⁷ WWC's bogus ETC certifications appear to extend beyond the Kansas and Oklahoma examples. TCA notes that WWC certified ETC status (and presumably received federal high-cost support) in the service area of Big Sandy Telecom to USAC through fourth quarter 2003 despite never receiving ETC status from the CoPUC. In first quarter

3. Despite Western's clear understanding that, in accordance with federal law, it was not qualified to obtain federal universal service support in Sprint territory at that time, Western filed its request for the support in Sprint areas with USAC, the administrator of the federal universal service fund, beginning in December of 2000.

4. Western has admitted that it *received* federal universal service support for its customers who reside in Sprint operating areas (Western Response, p. 2). However, Western attempts to brush aside the culpability of its actions, claiming that "receipt of such funds was inadvertent and based on a good faith interpretation of the Commission's Orders." (Western Response, p. 4)

5. It is difficult to believe that any interpretation – let alone a "good faith" one – of the Commission's Orders could arrive at the conclusion that Western was qualified to receive federal support payments out of Sprint territory. The Commission repeatedly explained to Western that for federal considerations, Sprint areas in Kansas are rural: Order #6 ¶ 38, "All wire centers in Kansas served by Sprint Telephone Company are rural wire centers"; Order #7 ¶ 12, "For federal universal service purposes, Sprint Telephone Company-Kansas is considered a rural telephone company"; Order #9 ¶ 6, "In Order #6 the Commission found that Western Wireless qualified for ETC status for the KUSF in Sprint territory, although not for federal USF support."

6. It is equally difficult to believe that receipt of the funds was "inadvertent", understanding that Western affirmatively requested the support from USAC. Furthermore, contrary to Western's claims (Western Response, p. 6), it appears from USAC records that Western received universal service support for Sprint territory on more than "one occasion".

7. Although this support flow has reportedly been terminated, Staff believes that the Commission should still be very concerned about *a carrier in Kansas which seemingly conducted itself in contradiction to federal law and Commission orders. Furthermore, Western's casual dismissal of its action intimates an abiding disrespect for Commission rules and the law, a characteristic that is surely not in the public interest.*³⁸

TCA observes that neither WorldCom nor WWC were subject to any earnings regulation when executing these fraudulent activities. It would not be unreasonable to conclude from these events, that it is unregulated entities like WorldCom and WWC requiring more regulatory scrutiny, not rural LECs subject to RoR regulation.

2004, WWC discontinued certifying ETC status to USAC, however, TCA is not aware that any unjustly received support was returned. See USAC Universal Service Fund Projection, HC03 Reports, 4th quarter 2003, found at <http://www.universalservice.org/overview/filings>.

³⁸ *In the Matter of the GCC License Corporation's Petition for Designation as an Eligible Telecommunications Carrier (d/b/a Western Wireless), Before the State Corporation Commission of the State of Kansas*, Staff's Reply to

V. Conclusion

For the reasons set forth above, and in TCA's initial comments, the Commission should swiftly reject the WWC Petition for Rulemaking. The WWC Petition is clearly duplicative as the Commission is already considering alternative regulatory regimes for rural LECs. Furthermore, the WWC Petition, and the comments supporting it, consist of little more than unsupported allegations, misquotations and faulty reasoning attacking rural LECs – the very carriers actually responsible for providing universal service in this nation. Finally, the timing of this Petition raises serious questions about the motive of the Applicant as it appears to be little more than a last ditch attempt to improperly influence the Commission regarding the ongoing Portability Proceeding before the Federal-State Joint Board on Universal Service.

Respectfully submitted,

By: [electronically filed]
TCA, Inc.-Telcom Consulting Associates
1465 Kelly Johnson Blvd., Suite 200
Colorado Springs, CO 80920
(719) 266-4334

February 13, 2004